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C O N F I D E N T I A L SECTION 01 OF 02 SOFIA 000177

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TAGS: PREL PARM ETTC RS BU

SUBJECT: UNDER PRESSURE FROM RUSSIA ON ARMS LICENSES,
BULGARIA SEEKS OUR ADVICE

REF: 06 SOFIA 1677

Classified By: Amb. John Beyrle, for reasons 1.4 (b) and (d).

¶1. (U) This is a guidance request. Please see paragraph 10.

¶2. (C/NF) SUMMARY: Russia has recently turned up the heat on Bulgaria in the long-running dispute over "licenses" for Soviet-designed small arms and light weapons. The GoB believes that Russia's claims are unfounded, but remains sensitive to Russian attempts to portray the dispute as an IPR or counterproliferation issue, thereby sullying Bulgaria's image in Brussels and Wassenaar. According to Bulgarian officials, the real issue is political, with Moscow seeking a veto over Bulgarian sales to countries such as Georgia. Bulgaria is eager to conclude a deal with Russia that will take this issue off the political front burner while protecting its arms industry. But the GoB has requested our views in advance to ensure that an eventual settlement with Russia does not harm our security partnership or create an obstacle to future Western cooperation with the Bulgarian defense industry. END SUMMARY.

¶3. (C/NF) Unlike most licensing disputes, Russia's interest in the Bulgarian defense sector has little to do with money (Russia's defense export monopoly, Rosoboronexport, counts annual sales in the billions, and would gain little from royalties on Bulgaria's defense exports, which approach \$100m annually). According to XXXXXXXXXXXX, the principal demand of the Russian side for years has been the institution of a "permissive regime," in which all exports of Soviet-designed systems would be treated as re-exports requiring Russia's consent. This proposal is fundamentally unacceptable to the Bulgarians -- the industry views it as a suicide pill while the government sees it as an affront to Bulgarian sovereignty. Still, the GoB is eager to move this festering issue from the political to the commercial realm.

¶4. (C/NF) Foreign Minister Kalfin was noticeably annoyed when the Russians pushed this issue to the top of the bilateral agenda during Kalfin's visit to Moscow last December (reftel), essentially blocking progress on other issues until the "licensing" question is resolved. Bulgaria also worries about the potential for "made to order" damage to its international reputation. According to XXXXXXXXXXXX, Russian money is funding critical stories about the Bulgarian arms industry "every week" in the Western European press, attempting to use the dispute to suggest that Bulgaria is pirating Russian intellectual property or that the Bulgarian defense industry poses a dangerous proliferation threat.

Bulgaria tries to defend itself, XXXXXXXXXXXX said, but cannot compete with Russian resources.

Bulgaria's proposal:

¶ 15. (C/NF) Bulgaria's response has been to suggest a compromise deal that would allow the GoB to negotiate directly with Russia on the systems it uses for its own military (such as the Mi-17 and Mi-24 helicopters which it has so far been unable to modernize without Russian parts) while allowing private Bulgarian companies to negotiate directly with Rosoboronexport on licensing terms for the systems they continue to use.

¶ 16. (C/NF) Bulgarian defense firms like this approach because they prefer to negotiate for themselves rather than face complying with an agreement negotiated by the government. Some Bulgarian firms are interested in the possibility of commercial ties with Russia (a wider choice of suppliers, etc) which are currently impossible due to the licensing dispute. Their self-confidence is bolstered by their calculation that, as private firms, Russia would have little direct leverage over them. If a diplomatic agreement were signed but the firms failed to agree to terms with Rosoboronexport, they believe that Russia would not be able to do much about it. According to XXXXXXXXXXXX, that's precisely the idea: the GoB's goal isn't to bind the hands of its industry, but instead to kick the issue from the diplomatic to the commercial arena.

The catch?

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¶ 17. (C/NF) While the Bulgarian government tells us that it will never agree to seek Russian consent before selling weapons abroad, Radomirski and experts at the Ministry of Energy and Economy (MoEE) advise us that this is exactly the sort of deal that Russia is likely to seek if its state-owned firms negotiate directly with Bulgarian arms producers. Several variants are possible, according to Radomirski. Russia may seek an "informative" rather than "permissive" regime, in which it would only demand to be notified of Bulgarian sales abroad, or it could seek an outright ban on sales to countries of particular concern (he mentioned Georgia) in exchange for giving Bulgarian firms a free hand elsewhere.

¶ 18. (C/NF) Industry leaders, such as Arsenal Corp.'s Nikolai Ibushev and Arcus's Banko Bankov tell us that they would refuse to sign such a deal, and there is no apparent financial incentive for them to sacrifice access to defense markets. However, if such a deal were negotiated in a commercial context, Radomirski confirmed that the Bulgarian government would have little leverage to stop it.

Comment and guidance request:

¶ 19. (C/NF) GoB contacts and industry leaders think they have a formula that will allow them to get past this issue once and for all, but before they officially propose it to the Russians (in talks scheduled for the end of February) they want to know the USG opinion in order to better formulate their negotiating redlines. Both Radomirski and MoEE Export Control Chief Ivelina Bachevanova have asked if the U.S. government has an official position on potential solutions to the licensing issue. In particular, they and arms company owners worry that signing an arms licensing deal with Russia -- particularly one that includes a "permissive regime" -- will render them ineligible to participate in lucrative USG contracts to supply the Iraqi and Afghan national armies, and may even result in U.S. pressure for other foreign markets to close their doors to Bulgarian weapons.

¶10. (C/NF) Post requests Department guidance in responding to the GoB on this issue. If possible, the GoB would appreciate a response in advance of bilateral consultations with Russia to be held in late February (exact date TBD).

Legal background:

¶11. (C/NF) Bulgarian policymakers and defense industry officials are united in the opinion that the dispute with Russia over Soviet-era weapons systems is not a licensing or intellectual property dispute in the true sense of the terms.

According to them, the weapons systems in question were never patented and the agreements that governed weapons production among Warsaw Pact countries did not have the legal character of licensing agreements. Moreover, the basic designs of some weapons (e.g., the AK-47 assault rifle) are more than 50 years old and have been widely adapted and produced throughout the world. Taking the high figure of some 720 disputed agreements claimed by the Russian side, the Bulgarians say that 340 contained no provision for payment, while others included significant obligations for the Soviet Union (e.g., to immediately provide technical documentation in case of systems upgrades or to deliver components) which were breached by Russia in the 1990s. When Russian suppliers stopped delivering, Bulgarian firms were forced to modify original designs and substitute suppliers, resulting (in some cases) in a fundamentally different product. For these reasons (and to avoid any potential complications following Russia's eventual WTO accession) Bulgaria insists that "licenses" are not the issue, and that any royalties paid be treated as fees for spare parts or technical documentation.

BEYRLE